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PERMITTING ASSET REVALUATION AFTER SALES(U) GENERAL
ACCOUNTING OFFICE WASHINGTON DC HUMAN RESOURCES DIV
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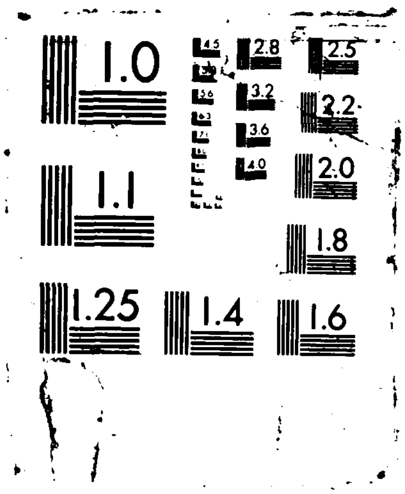
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United States General Accounting Office

Report to Congressional Committees

April 1988

MEDICAID

Little Effect From Legislative Change Permitting Asset Revaluation After Sales

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

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April 8, 1988

The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

The Honorable John D. Dingell
Chairman, Committee on Energy and Commerce
House of Representatives

Section 9509 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA, Public Law 99-272, Apr. 7, 1986) revised the Medicaid statute to permit the upward revaluation of assets when a new owner purchases a nursing home. Such revaluation can result in increased Medicaid payments to nursing homes for capital costs—primarily depreciation and interest expense on loans taken for the acquisition. Section 9509 required us to study the effects of the revaluation-of-assets change on the Medicaid program.

The amendment made by section 9509 has to date had minimal effect on Medicaid. As of October 1987, only three states—Alabama, Alaska, and Virginia—had changed their Medicaid nursing home payment methods to permit revaluation of assets after a sale. The effect on Medicaid costs is expected to be small in all three states because relatively few nursing homes are expected to have changes of ownership. If additional states should change their revaluation policies, the effect on Medicaid costs could become more substantial. However, the state and federal officials responsible for Medicaid nursing home matters whom we contacted told us that they expect few, if any, other states to change their revaluation-of-assets policies.

Background

Medicaid is a grant-in-aid program under which the federal government shares in state costs of services furnished to eligible low-income individuals. The federal share ranges from 50 to 80 percent depending on a state's per capita income. States design and administer their Medicaid programs within broad federal guidelines. The Health Care Financing Administration (HCFA) within the Department of Health and Human Services (HHS) is responsible for reviewing and approving state Medicaid plans and monitoring state operations to assure that they meet federal requirements.

States are required to cover skilled nursing facility services and are allowed to cover intermediate care facility services and intermediate

care facility for the mentally retarded services. These three types of facilities constitute nursing homes for Medicaid purposes, and 49 of 50 states[1] and the District of Columbia cover all three types.

Until 1984, Medicare requirements related to nursing home sales permitted revaluation of assets but restricted the new valuation to the lowest of the purchase price, fair market value, or depreciated reproduction cost.[2] A number of states used Medicare criteria for Medicaid, and others had additional controls over capital costs. The Deficit Reduction Act of 1984 (DEFRA, Public Law 98-369, July 18, 1984) required that under Medicare and Medicaid, hospital and nursing home assets be valued after a sale at the lower of the purchase price or the old owner's acquisition cost. Section 9509 of COBRA amended this requirement for Medicaid to permit states to recognize revaluation of assets for nursing homes with the increase in value above the old owner's acquisition cost limited to the lower of 50 percent of the increase in the Dodge Construction Systems Costs for Nursing Homes[3] or 50 percent of the increase in the Consumer Price Index for all Urban Consumers, both calculated over the period of time the seller owned the facility.

The states were required to make written assurances to HCFA that their nursing home payment methods complied with the DEFRA, and then with the COBRA, provision. After reviewing and in some cases seeking clarifications or additional information, HCFA accepted the state assurances.

Objectives, Scope, and Methodology

Our objective, as required by COBRA, was to assess the effects of the modification to federal Medicaid policy for revaluation of nursing home assets after sales made by section 9509 of that act. Our primary concerns were whether states changed policy in response to COBRA and, if so, the effects on Medicaid program costs.

[1] Arizona operates a Medicaid program under a special waiver and does not cover nursing home services. American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands also receive limited federal funding for their Medicaid programs, but we did not include them in our review.

[2] Reproduction cost was defined as the amount it would cost to build the same facility at current prices, and this amount was depreciated to reflect the remaining useful life of the facility.

[3] This is an economic index designed to measure the change in the costs of constructing facilities. It is produced by a private concern, Dodge Cost Systems.

To accomplish this, we obtained the portions of the state Medicaid plans applicable to nursing home payment methods for the District of Columbia and all states (except Arizona, which does not cover nursing home services under Medicaid) reflecting their changes in responses to DEFRA and their letters of assurance to HCFA stating that their nursing home payment policies complied with the DEFRA provision. We also obtained the nursing home portions of the state Medicaid plans current as of October 1987. We reviewed these documents to determine if any changes to nursing home revaluation policies had occurred after COBRA.

We obtained written comments from each of HCFA's 10 regional offices on whether states under their jurisdiction had changed policy based on the COBRA amendment, the effect on costs of any changes, and the likelihood of any additional changes. We also contacted officials responsible for Medicaid nursing home payment policy in 18 states about the same issues as we asked the HCFA regional offices. The 15 states we contacted,[1] in addition to the 3 that had made changes after COBRA, were selected to provide geographic coverage of the nation. We performed this work from September 1987 through February 1988.

We asked HHS to comment on this report. HHS provided some technical comments, which were considered in finalizing this report.

Three States Have Changed Revaluation-of-Assets Policy

All states except Alaska[2] assured HCFA that their nursing home payment methods met DEFRA's requirement that a change in ownership not result in an increase in Medicaid capital payments. While a number of states revised their payment methods, 19 states assured HCFA that no change was needed to comply with DEFRA. These states generally used a payment system under which the amount a nursing home received was established in advance and not directly based on the home's actual costs. Thus, if the sale of a nursing home resulted in the new owner's capital costs being higher, it did not directly affect the amount Medicaid paid the nursing home.

The other states used payment systems under which capital cost payments are more directly linked to a nursing home's actual costs. In such states, a change in policy to reflect the COBRA-permitted revaluation of

[1]Delaware, Georgia, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Mississippi, Nebraska, New Jersey, New York, North Dakota, Ohio, Oregon, and Pennsylvania.

[2]Alaska did not immediately change its policy but assured HCFA it would absorb with state funds any increase in capital payments that resulted from nursing home sales. See p. 4

assets would be more likely to increase Medicaid payments because revaluation would increase the costs that could be claimed under the program.

Our review of the state Medicaid plans and assurance letters showed that as of October 1987, only three states—Alabama, Alaska, and Virginia—had changed nursing home payment methods affecting capital payments in response to COBRA. All three states believed that other provisions of their Medicaid nursing home payment methods or other factors related to nursing homes in the state would result in minimal effects on Medicaid costs from the change to the COBRA provision.

Alabama

In response to DEFRA, Alabama modified its nursing home capital payment method to prohibit revaluation of assets after sales of nursing homes. Effective November 10, 1987, the state again modified its method to reflect the COBRA change permitting some revaluation. A state official responsible for nursing home payment matters told us that the change was made because most nursing homes in the state were family businesses and the DEFRA restriction held down the amount of capital gains on sales of a facility at retirement time. The official stated that, although some increase in Medicaid payments for interest and depreciation would result from the change, the increase will not be significant. The official based this assessment on the fact that Alabama retained several other features of its method designed to contain capital payments. Specifically,

- capital costs are limited to those reflecting asset valuations of no more than $16,600 per bed;
- payment rates are limited to the 60th percentile of statewide average nursing home costs; and
- a nursing home must be owned for at least 7 years before the state will recognize increased capital costs resulting from a sale, which discourages rapid turnover of homes.

Alaska

Alaska was in the process of changing its nursing home payment method to conform to DEFRA when COBRA was enacted. The state then decided to substitute the COBRA-allowed limitation for the planned DEFRA change and did so effective for sales occurring on or after October 1, 1985. According to the state, no nursing home sales occurred during the period between the enactment of DEFRA and the enactment of COBRA.

State documents indicate, and a state official told us, that the state expects little effect from using the COBRA basis for revaluation rather than the DEFRA basis. All the nursing homes in the state either are parts of community-owned hospitals or are owned by nonprofit organizations. Because most nursing home sales involve for-profit facilities, the state expects few sales to occur. The state official told us that no sales have occurred since 1972.

Virginia

Virginia's Medicaid nursing home payment method used the DEFRA prohibition on upward revaluation after sales until it was changed in response to COBRA. Effective for sales on or after October 1, 1986, the state plan incorporated the COBRA basis for revaluation after sales.

According to a state official responsible for nursing home payment methods, the state changed to the COBRA limit because the nursing home industry desired the change. The official said that the state did not anticipate a large increase in Medicaid costs to result because few changes in nursing home ownership are expected to occur. He also said the Medicaid program recaptures depreciation from the seller when sales result in capital gains and this offsets to some extent the allowed increase in capital costs from revaluation.[6]

Reasons Other States Have Not Changed Policy

We contacted state Medicaid officials in 15 other states to obtain their assessments of why the states had not changed their capital payment method and the likelihood of future changes. The responses generally can be categorized into three types:

- A change in policy would result in increased Medicaid costs, which would be unacceptable to the state.
- The state had controls on capital payments before DEFRA and the COBRA change would be more liberal than the pre-DEFRA controls.
- The state made a policy change to meet the DEFRA requirement and felt it was too soon to make another change.

The state officials generally said that they saw little likelihood of a change in capital payment policy in the immediate future. HCFA regional

[6]When assets are sold for more than book value, the program is entitled to share in the gain. The portion of gain in which the program shares is limited to the amount of accumulated depreciation previously claimed as reimbursable costs from Medicaid.

office officials also told us that they expected few, if any, additional states to make changes in response to the COBRA provision.

Conclusion

Because only three states have changed policy in response to the COBRA provision allowing revaluation of assets after sale of nursing homes, that provision has had little effect on the Medicaid program. Neither HCFA nor the states anticipate many states changing policies, mainly because policy changes would increase state costs.

If additional states do change capital cost policies, especially those that make payments based on an individual nursing home's costs, it could have a significant effect on Medicaid costs. However, we agree with the assessment of state and HCFA officials that such changes are unlikely because they would increase state costs in a time of limited state budgets.

We are sending copies of this report to other congressional committees; the Director, Office of Management and Budget; the Secretary of Health and Human Services; the Administrator of HCFA; and other interested parties.

Michael Zimmerman

Michael Zimmerman
Senior Associate Director

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